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SUBJECT: DOMINICAN TREASURY CONCERN ABOUT IMF NEGOTIATIONS,
POSSIBLE ACTION AGAINST EXCHANGE SPECULATORS

REF: KUBISKE & MEIGS E-MAILS/WHA-WHA/CAR-TREASURY-EB

1. (SBU) Summary. Dominican Technical Secretary of the Presidency Carlos Despradel says that President Mejia and his team are close to an agreement with the IMF but are concerned that speculation in the foreign exchange market may be undermining all calculations. Strong action against speculators is possible. End summary.

2. (U) DCM and EcoPol Counselor were invited to meet Technical Secretary of the Presidency Carlos Despradel on November 26 for a read-out of talks with the IMF, as a follow-up to the visit of Treasury Under Secretary John Taylor. Embosfs were received by technical advisor Luis Reyes Santos, who mentioned that IMF team leader Figuerola and IMF resrep Mandeng were both in flight to Washington for Thanksgiving holiday. One fiscal specialist, Geremia Palomba, is still in Santo Domingo but was out of contact.

3. (SBU) Technical Secretary Despradel arrived ten minutes later, directly from a meeting with President Mejia. He provided a chart of the IMF negotiations as of November 24 and November 25:

PROGRAM AS OF NOVEMBER 24:	Percent of GDP
1. Central Bank quasi-fiscal deficit	- 4.0
2. Electricity Sector	
includes rate increases averaging 42 percent	
(1% monthly adjustments for consumers of	
less than 300 kw, 4% monthly adj for consumers	
of 300-700 kw, elimination of subsidies for	
all consuming more than 700 kw0); total	
of subsidies is 0.8 percent GDP	
-1.0	
- - - - -	
SUBTOTAL DEFICIT (1 2)	-
5.0	
GOVERNMENT SURPLUS, including	
Measures to reduce expenditures by	
a further 1.1 percent of GDP; includes	
the projected yield of the 5% export tax	
0.5	
- - - - -	
GLOBAL DEFICIT	
- 4.5 percent	
GAP requiring financing, according to IMF	1.0
percent	

AS OF NOVEMBER 25

Proposed additional measures

1. Further spending cuts (0.4 percent)
2. New taxes (0.6 percent)
1.0 percent

4. (SBU) Despradel stressed that adding further taxes would be a very difficult undertaking and could well delay approval of the 2004 budget beyond the December timeframe. President Mejia has told advisors that he is determined to reach agreement with the Fund and says that he will persuade congress and other interests of the need to enact them. Despradel said that one approach might be raising the VAT from 12 percent currently to 14 or 15 percent, with exceptions for basic necessities.

5. (U) Note. President of the Business Council (CONEP) Elena Viyella has emphasized to us in recent days that businesses find unacceptable the draft for the 5 percent tax on exports. In the version approved by the Senate there is no legal mechanism specified for collecting the tax. CONEP believes that the law should to some extent mirror the mechanisms and rates embodied in the private sector voluntary agreements made with the administration since October. She notes that the export tax doesn't address Free Zone exports and is not adequate in dealing with the dollar earnings of the hotel sector.

Central Bank debt - Request to USG

16. (SBU) Despradel stressed the deep concern of the financial team about the short-term debt held by the Central Bank (CB) in the form of certificates of deposit (largely originating as guarantees of Baninter deposits). He estimates this stock at 60 billion pesos currently. At an annualized interest rate of 30 percent, the CB will have to issue further certificates regularly to offset the liquidity created by interest payments. The program projects the resulting stock of CB debt at 65 billion in March 2004, 76 billion in June, 84 billion in September, and 81 billion (sic) in December. Despradel supposes that in unchanged circumstances the debt would rise from 81 billion to 100 billion in 2005. He finds unrealistic the IMF suggestion to raise taxes further so as to offset this growth in debt.

7.(U) Note. Banks are growing increasingly reluctant to roll over the government's short term debt. The most recent offering was of 7.5 billion pesos -- and only 4.8 billion was placed at an average maturity of 19.1 days. None of the CB offerings over the past ten weeks has been fully subscribed.

18. (SBU) Despradel and staff are preparing a letter to the USG through U/S Taylor requesting help in obtaining a large sum of financing so as to reduce the stock of CB certificates and lower payments. They want to restructure the debt into long-term obligations, perhaps in dollars, and to lower the rate.

(SBU) Rumors, liquidity, exchange rate -- arrests?

19. (SBU) Despradel said the President's meeting that morning had been scheduled to examine the possible elements of expenditure cuts and new taxes. Participants had concentrated instead on the upsurge in rumors and pressure related to the exchange rate. "Very strong" rumors assert that further banks are in trouble (to our understanding, this view is erroneous). The peso is trading currently at about 45 to the dollar, up from about 41 earlier this week. Despradel said that the administration believes that there is a deliberate effort to instill panic so as to drive the exchange rate yet higher. Well-respected business persons are asking for government action, and "the President thinks that something must be done."

110. (SBU) Despradel said that there is a strong possibility that the government will take action against exchange houses and individuals thought to be engaged in this effort. The administration might make high profile raids for tax inspections or might ask for arrest warrants. Despradel says that he himself is very moderate on these questions and knows that the effect might be negative -- but the policymakers are tending to the view that market manipulation must be stopped, to prevent the rate from hitting 50 to the dollar. &This is a very delicate moment.8

111. (SBU) Note. The IMF team suggested that the GODR could go onto the market to purchase dollars for international payments of US \$ 150-200 million due from now until the end of calendar year 2003. This would place additional demand on the exchange market.

112. (U) Despradel stressed that the IMF negotiations have been premised on an exchange rate of about 40 pesos to the dollar. Further depreciation of the currency would mean complete redrawing of the program.

Request: Fund flexibility

113. (SBU) Despradel does not believe it is possible to make any public statement about the status of the negotiations with the fund. He asks that the USG seek to convince the Fund negotiators to be more flexible. He understands their institutional interest in staying tough but is concerned that &this approach could destroy the country."

114. (U) Expenditures. The Technical Secretary provided in tabular form a summary of government expenditures for 1995 (14.3 percent of GDP in Balaguer's last year), 1999 (16.2 percent of GDP in Fernandez's last year) and 2003 (15.1 percent), as a defense against assertions of lavish spending by the Mejia administration.

115. (SBU) Further IFI loans. Despradel says that the InterAmerican Development Bank is planning a fast disbursing loan of US \$ 200 million, with \$150 million in the first tranche. The World Bank is planning a Structural Adjustment Loan of US \$80 million (Despradel will ask for US \$100 million) "to keep the lights on." Of this, about US \$70 million would be used for energy. The loan's conditions will require maintaining levels of social expenditures.

KUBISKE